

Inspector General

United States
Department of Defense



Army Commercial Vendor Services Offices in Iraq
Noncompliant with Internal Revenue Service
Reporting Requirements

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Acronyms and Abbreviations

CAGE	Commercial and Government Entity
CAPS-C	Computerized Accounts Payable System-Clipper
CCR	Central Contractor Registration
CVS	Commercial Vendor Services
DFAS	Defense Finance and Accounting Service
DoD FMR	DoD Financial Management Regulation
FMC	Financial Management Center
FMCOM	U.S. Army Financial Management Command
IRS	Internal Revenue Service
OMB	Office of Management and Budget
SOP	Standard Operating Procedure
U.S.C.	United States Code



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

April 8, 2011

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Army Commercial Vendor Services Offices in Iraq Noncompliant
with Internal Revenue Service Reporting Requirements
(Report No. D-2011-059)

We are providing this report for your information and use. Army Commercial Vendor Services personnel in Iraq processed service-related entitled payments totaling \$1.28 billion from January 1, 2006, through December 31, 2008. Army Commercial Vendor Services personnel did not take action to file Federal information returns with the Internal Revenue Service for an estimated \$351.92 million of incorrectly coded domestic contractor payments for services and an estimated \$248.66 million of potentially incorrectly coded contractor payments for services rendered. We considered management comments on a draft of this report when preparing the final report.

Management comments conformed to the requirements of DoD Directive 7650.3. We received comments from the Acting Director, Standards and Compliance, Defense Finance and Accounting Service; the Commander, U.S. Army Financial Management Command; and the Director, Financial Management Center on recommendations made to this report. The comments and actions were responsive and no further comments are required.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5868 (DSN 329-5868).

Patricia A. Marsh
Patricia A. Marsh, CPA
Assistant Inspector General
Financial Management and Reporting



Results in Brief: Army CVS Offices in Iraq Noncompliant with Internal Revenue Service Reporting Requirements

What We Did

We determined whether Army Commercial Vendor Services (CVS) in Iraq complied with Federal tax reporting requirements for payments made to contractors supporting operations in Southwest Asia. Our audit focused on 15,093 service-related entitled payments (payments) totaling \$1.28 billion that Army CVS offices in Iraq processed through the Computerized Accounts Payable System-Clipper (CAPS-C) from January 1, 2006, through December 31, 2008.

What We Found

Of 14,699 payments, Army CVS personnel incorrectly coded domestic contractors as foreign in CAPS-C for an estimated 316 payments totaling an estimated \$351.92 million, and may have incorrectly coded domestic contractors as foreign in CAPS-C for an estimated 5,054 payments totaling an estimated \$248.66 million. This occurred because Defense Finance and Accounting Service (DFAS) and Army financial management officials did not establish standard operating procedures (SOPs) for coding contractor domain status. In addition, Army financial management officials did not adequately train Army CVS personnel to code contractor domain status. As a result, Army CVS personnel did not take action to file Federal information returns with the IRS for an estimated \$351.92 million of incorrectly coded contractor payments and an estimated \$248.66 million of potentially incorrectly coded contractor payments.

Army CVS personnel coded some contractors as domestic for 394 payments in CAPS-C; however, Army CVS offices did not file the Federal information returns or send the CAPS-C tax file to the DFAS Tax Office. This

occurred because the DoD FMR did not include all reporting requirements for Federal information returns that Federal laws specify. In addition, Army financial management officials did not have SOPs for filing Federal information returns. As a result, Army CVS offices did not comply with Federal laws for filing Federal information returns.

What We Recommend

DFAS should establish SOPs for correctly coding contractor domain status and distribute the annual quality assurance plan for tax filing procedures to U.S. Army Financial Management Command.

U.S. Army Financial Management Command should develop SOPs for filing Federal information returns and update training to address coding contractor domain status, completing CAPS-C data fields, and preparing CAPS-C tax files.

The Financial Management Center should implement procedures for filing Federal information returns, update training to address coding contractor domain status and producing CAPS-C tax files, and correctly code domestic contractors and issue Federal information returns for reportable payments made by Army CVS offices from January 1, 2006, forward.

Management Comments and Our Response

All management comments and actions were responsive to the recommendations, and we do not require additional comments.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Finance and Accounting Service		A.1, B.1
Commander, U.S. Army Financial Management Command		A.1, A.2.a, A.2.b, B.2.a, B.2.b, B.2.c
Director, Financial Management Center		A.1, A.2.a, A.2.b, B.3.a, B.3.b, B.3.c

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Introduction

Audit Objective

The objective of the audit was to determine whether the Commercial Vendor Services (CVS) offices in Iraq complied with Federal tax reporting requirements for payments to contractors in support of operations in Southwest Asia for calendar years 2006 through 2008. See Appendix A for the scope and methodology and prior audit coverage related to this report. See Appendix B for a copy of the 2008 Form 1099-MISC, “Miscellaneous Income.” See Appendix C for detailed information about the work performed by our Quantitative Methods and Analysis Division.

Background on Army CVS Office Tax Reporting

From January 1, 2006, through December 31, 2008, Army CVS offices in Iraq processed 15,093 service-related entitled payments totaling \$1.28 billion through multiple stand-alone Computerized Accounts Payable System-Clipper (CAPS-C) entitlement systems.¹ The payments were for services contracts with domestic and foreign contractors. Contractors with a domestic domain status are:

- individuals who are U.S. citizens or resident aliens of the United States, or
- corporations or partnerships created or organized in the United States.

Foreign contractors are individuals, corporations, or partnerships that do not meet the criteria to be domestic contractors.

Contractors with a domestic domain status receiving eligible payments should receive a Federal information return form. The Internal Revenue Service (IRS) uses Federal information returns to identify taxpayers who failed to file an income tax return as well as those who failed to report all their income. Federal information returns are a powerful tool for encouraging voluntary tax reporting compliance and detecting underreported income. According to a prior audit report by the Government Accountability Office, the IRS does not know the extent of payer noncompliance with Federal information return reporting requirements.² However, according to the IRS National Taxpayer Advocate in a statement before the U.S. Senate Subcommittee on Taxation and IRS Oversight, July 2006:

Where payments are subject to withholding, the reporting compliance rate is 99 percent. Where payments are subject to third-party information reporting (e.g., interest and dividend income), reporting compliance is the neighborhood of 96 percent. But where there is little

¹ From this point forward, service-related entitled payments will be referred to as “payments.”

² Government Accountability Office Report No. GAO-09-238, “Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements,” January 2009.

to no information reporting, compliance plummets dramatically to somewhere in the range of about 50 percent overall.

Operations and Functions of Army Financial Management Units

Army financial management operations personnel make commercial vendor and contractual payments. Financial management functions include:

- making payments on certified vouchers; and
- developing fiscal guidance and ensuring that regulatory guidelines, directives, and procedures are adhered to.

Army financial management functions occur at the strategic, operational, and tactical levels. At the strategic level, the U.S. Army Financial Management Command (FMCOM)³ is responsible for oversight and policy of Army finance operations. At the operational level, the Financial Management Center (FMC) links strategic and tactical financial management and is the principal advisor to the theater commander on all aspects of finance operations. FMC provides technical oversight of all theater finance operations, including Army CVS offices. Its oversight includes developing financial management policy and procedures for theater implementation.

At the tactical level, Army financial management companies coordinate and execute financial management support within the FMC's area of operations. Financial management support functions include ensuring that all operational elements of the financial management company and subordinate financial management detachments adhere to regulatory guidelines, directives, and procedures. Financial management detachments are responsible for providing timely and accurate payment for contractor and commercial vendor services, disbursing, and funding support.

Army CVS offices are usually financial management detachments. They are responsible for preparing, auditing, and processing vouchers for supplies, equipment, and services purchased by the Government. Army CVS personnel in Iraq use the CAPS-C automated entitlement system, which can receive input electronically or manually based on submitted contracts and invoices, such as those for security services. CAPS-C produces vouchers for contracts and can generate a tax file of contractors required to receive Federal information returns. Army CVS personnel can then either:

- self-file the Federal information returns; or
- send the CAPS-C tax file to the DFAS Tax Office, and the DFAS Tax Office will file the Federal information returns.

Federal Information Return Reporting Requirements

Section 6041, title 26, United States Code (26 U.S.C. § 6041 [2007]), requires reporting certain payments made by a person or the U.S. Government if they total at least \$600 in a

³ Prior to May 1, 2010, FMCOM was designated the U.S. Army Finance Command.

taxable year. Section 6041A, title 26, United States Code (26 U.S.C. § 6041A [2008]), requires reporting payments for services totaling at least \$600 in a calendar year. Further, 26 U.S.C. § 6041A (2008) specifically requires Federal executive agencies, such as DoD, to report payments to corporations for their services. The agency reporting the payments provides a copy of the Federal information return to the IRS, as well as to the contractor. The IRS uses Federal information returns to match amounts paid to contractors to what the contractors report on their annual income tax returns. Federal Acquisition Regulation 4.904, “Reporting payment information to the IRS,” 26 U.S.C. § 6041 (2007), and 26 U.S.C. § 6041A (2008) require payers, including Government agencies, to use Federal information return Form 1099 to report contractor payments for services. See Appendix B for the 2008 Form 1099-MISC, “Miscellaneous Income.”

IRS instructions require reporting payments totaling at least \$600 for services (including parts and materials). Reportable items include payments for:

- rent, such as vehicle and equipment leases;
- services, such as advertising, equipment maintenance, and other professional services; and
- medical and health care, such as exam and hospital fees.

DoD Regulation 7000.14-R, “DoD Financial Management Regulation” (DoD FMR), volume 10, chapter 6, “Federal, State, Local, and Foreign Taxes,” requires disbursing offices to report certain payments to the IRS. However, the DoD FMR required disbursing offices to report payments totaling at least \$600 to a contractor in a calendar year only if they made the payments to noncorporate contractors for services or to corporations providing medical and health care services. In September 2009, DoD FMR, volume 10, chapter 6, was updated to require reporting of payments for services when made to individuals, sole proprietorships, partnerships, or corporations.

Internal Controls Not Effective for Tax Processing

We determined that internal control weaknesses existed in the Army CVS offices’ Federal information return reporting process, as defined by DoD Instruction 5010.40, “Managers’ Internal Control (MIC) Program Procedures,” January 4, 2006. Army CVS offices lacked internal controls to correctly code contractors’ domain status in CAPS-C. In addition, Army CVS offices did not have adequate internal controls to file Federal information returns or provide tax files to DFAS Tax Office for filing. We will provide a copy of the report to the senior official responsible for internal controls in the Department of the Army.

Finding A. Contractor Domain Status Incorrectly Coded in CAPS-C

From January 1, 2006, to December 31, 2008, Army CVS personnel incorrectly coded the contractor domain status of domestic contractors as foreign during the vendor pay process and may have incorrectly coded the contractor domain status of other domestic contractors as foreign. This occurred because DFAS, FMCOM, and FMC did not establish formal standard operating procedures (SOPs) for Army CVS personnel to correctly code the domain status of contractors in CAPS-C. In addition, FMCOM and FMC did not adequately train Army CVS personnel to code contractor domain status.

As a result, Army CVS personnel did not take action to file Federal information returns for an estimated 316 incorrectly coded payments, totaling an estimated \$351.92 million, to the IRS. Further, Army CVS personnel did not take action to file Federal information returns for an estimated 5,054 potentially incorrectly coded payments, totaling an estimated \$248.66 million, to the IRS. In addition, by not adequately training Army CVS personnel, FMCOM and FMC did not comply with Office of Management and Budget (OMB) regulations.

Army CVS Offices Processed Payments for Domestic Contractors Through CAPS-C

Army CVS offices processed 15,093 payments through CAPS-C systems from January 1, 2006, through December 31, 2008.⁴ Of the 15,093 payments, system-identified foreign contractors received 14,699 payments, and system-identified domestic contractors received 394 payments. A statistical sample from the 14,699 payments in CAPS-C was used to test voucher packages to determine whether all of the contractors in the sample were correctly coded as foreign in CAPS-C. The group of 394 payments to system-identified domestic contractors was tested separately (see Finding B).

Vendor Pay Personnel Code Contractor Domain Status as Domestic or Foreign

In the vendor pay process, vendor pay personnel are required to identify a contractor's domain as either domestic or foreign. According to 26 U.S.C. § 6041 (2007) and 26 U.S.C. § 6041A (2008), Federal agencies must file Federal information returns for payments made to corporations, partnerships, and individuals. Additionally, section 1, title 26, United States Code and section 11, title 26, United States Code apply a tax on every corporation, partnership, and individual's taxable income. Foreign entities are exempt as long as the conduct of trade or business is performed outside of the United States.

⁴ From calendar years 2006 through 2008, CVS offices in Iraq entitled 24,252 payments related to either goods or services through CAPS-C.

Federal information returns from Army CVS offices are based on information provided in CAPS-C. When vendor pay personnel enter contractual information in CAPS-C, the “Foreign Vendor?” field automatically defaults to “No,” establishing the contractor as domestic. For foreign contractors, vendor pay personnel must override the default and enter “Yes” in the “Foreign Vendor?” field to establish the contractor as foreign. The system will only produce Federal information returns for contractors coded as “No” (domestic) in the “Foreign Vendor?” field. In addition to the “Foreign Vendor?” field, CAPS-C needs data in the “Amount Indicator” field, which identifies the purpose of the payment, and the “Corporate Status” field, which identifies the organization type, to produce Federal information returns.

Vendor pay personnel review information from the contract when entering the information into CAPS-C. According to DFAS personnel, vendor pay personnel look for the contractor’s Commercial and Government Entity (CAGE) code on the contract. They use the CAGE code to search the Central Contractor Registration (CCR) database, the primary Government repository for contractor information, for the contractor’s domain status. However, DFAS personnel described different methodologies for determining contractor domain status when a CAGE code is not provided. To determine a contractor’s domain status, vendor pay personnel may look at:

- the contractor’s name and address, or
- the payment currency on the contract.

For example, if both the name and address or the payment currency is foreign, the contractor is coded as foreign in CAPS-C. It is essential that the identification of the “Foreign Vendor?,” “Amount Indicator,” and “Corporate Status” fields reflect the actual status of the contractor because Federal information returns are filed based on information from the vendor pay systems.

Army CVS Personnel Incorrectly Coded Domestic Contractors as Foreign in CAPS-C

From January 1, 2006, to December 31, 2008, Army CVS personnel incorrectly coded domestic contractors as foreign in CAPS-C. Of the 14,699 payments made to

From January 1, 2006, to December 31, 2008, Army CVS personnel incorrectly coded domestic contractors as foreign in CAPS-C.

system-identified foreign contractors, an estimated 316 payments totaling an estimated \$351.92 million were made to domestic contractors. According to DFAS personnel, for 2008, vendor pay personnel at the Camp Victory CVS office routinely coded contractors as foreign

in CAPS-C because the contractors were performing services or providing goods outside of the United States. For example, a contractor providing services for the Multi-National Corps-Iraq was coded as foreign in CAPS-C. Although the documents provided did not list a CAGE code, the name and address of the contractor were domestic, and the contractor was paid in U.S. dollars. Therefore, by using the methods described by DFAS personnel, Army CVS personnel should have coded the contractor as domestic. The contractor was located in the CCR database through a name search and verified as

domestic. The payment to this contractor was eligible for a Federal information return. Army CVS personnel neither issued Federal information returns for an estimated 316 payments to domestic contractors nor took the necessary action to file Federal information returns for the estimated 316 domestic contractor payments.

Army CVS Personnel May Have Incorrectly Coded Contractors with an Indeterminable Domain or Reporting Status as Foreign in CAPS-C

Army CVS personnel may have incorrectly coded contractors as foreign for an estimated 5,054 payments of 14,699 payments, totaling an estimated \$248.66 million, from January 1, 2006, through December 31, 2008. The documents DFAS provided did not include the information needed to determine whether these payments were possibly reportable on Federal information returns. The methodologies described by DFAS personnel also did not lead to a definite domain status of the contractors associated with these payments.

Army CVS personnel coded contractors with domestic names, foreign addresses, and payment currency in U.S. dollars as well as contractors with foreign names, foreign addresses, and payment currency in U.S. dollars as foreign in CAPS-C. For these contractors, the domain status in the CCR database could not be verified. Some of these payments were for reportable services; however, a verifiable contractor's domain status is necessary to determine whether a Federal information return should be filed. In addition, for some payments to contractors with an indeterminable domain status, the documents DFAS provided did not include the information needed to determine whether these payments were for reportable services.

Army CVS personnel also incorrectly coded domestic contractors as foreign in CAPS-C when identifying the reporting status. The documents DFAS provided did not include the information needed to determine whether these payments were for reportable services. According to documents we reviewed and FMCOM and FMC personnel we interviewed, Army CVS offices did not issue Federal information returns for these payments for 2006 through 2008. Therefore, Army CVS personnel did not take action to file Federal information returns for potentially eligible contractors.

Army CVS Personnel Need Procedures and Training to Code Contractor Domain Status

Army CVS personnel incorrectly coded domestic contractors as foreign because DFAS, FMCOM, and the FMC did not establish formal SOPs to guide personnel responsible for coding contractor domain status. Additionally, FMCOM did not ensure that the FMC and Army CVS personnel were properly trained to code contractor status. As a result, Army CVS personnel did not take action to file Federal information returns for an estimated \$351.92 million of incorrectly coded payments and may not have taken action to file Federal information returns for an estimated \$248.66 million of potentially incorrectly coded payments to the IRS.

Army CVS Personnel Did Not Have Procedures to Correctly Code Contractor Domain Status

DFAS CAPS-C manuals . . . do not specify how to correctly code contractors as domestic or foreign.

DFAS, FMCOM, and FMC did not establish formal SOPs for CAPS-C vendor pay personnel to correctly code the contractor domain status. Army Field Manual No. 1-06 states that DFAS is responsible for DoD finance and accounting

policies, procedures, standards, and systems operated by deployed financial management units. DFAS CAPS-C manuals require vendor pay personnel to code contractor domain status but do not specify how to correctly code contractors as domestic or foreign. In addition, FMCOM and FMC did not establish SOPs for vendor pay personnel to code contractor domain status.

Army CVS Personnel Did Not Have Adequate Training to Correctly Code Contractor Domain Status

FMCOM and FMC did not ensure that Army CVS personnel were properly trained to correctly code contractor domain status in CAPS-C. According to OMB Circular No. A-123, management must clearly support appropriate human capital policies for training and uphold the need for personnel to possess and maintain the proper knowledge and skills to perform their assigned duties. Based on training materials, Army CVS personnel were instructed to complete certain entries for contractors based on their domain status. However, the training materials did not provide specific guidance on coding the contractor domain status. As a result, FMCOM and FMC did not comply with OMB Circular No. A-123 requirements to ensure that Army CVS personnel had the proper training, knowledge, and skills to perform their duties. Without providing adequate training to Army CVS personnel, the risk of miscoding increases.

Conclusion

From January 1, 2006, to December 31, 2008, Army CVS personnel incorrectly coded the contractor domain status of domestic contractors as foreign during the vendor pay process. Specifically, Army CVS personnel incorrectly coded domestic contractors as foreign in CAPS-C, which did not provide accurate information for filing Federal information returns.

DFAS, FMCOM, and the FMC should have established formal SOPs for Army CVS personnel to code contractor domain status. In addition, FMCOM and FMC should have ensured that Army CVS personnel were properly trained to code contractor domain status. Because Army CVS personnel did not have formal SOPs or adequate training, they did not code contractor domain status correctly. As a result, Army CVS personnel did not take action to file Federal information returns with the IRS for an estimated \$351.92 million of incorrectly coded payments and an estimated \$248.66 million of potentially incorrectly coded payments from 2006 through 2008.

Recommendations, Management Comments, and Our Response

A.1. We recommend the Director, Defense Finance and Accounting Service, in conjunction with the Commander, U.S. Army Financial Management Command, and the Director, Financial Management Center, establish formal standard operating procedures to guide Army Commercial Vendor Services personnel in correctly coding the contractor domain status as either domestic or foreign in the Computerized Accounts Payable System-Clipper.

DFAS Comments

The Acting Director, Standards and Compliance, DFAS agreed, stating that DFAS has completed a quality assurance plan. According to the Acting Director's comments, the quality assurance plan advises Army CVS personnel how to:

- know which payments are reportable on tax documents,
- code payments,
- work the yearly Form 1099-MISC report, and
- generate the final yearly file.

The Acting Director reviewed the SOP that FMCOM personnel completed and recommended they issue the SOP to all applicable sites with some supplemental material.

Our Response

The Acting Director, Standards and Compliance, DFAS, comments were responsive, meeting the intent of the recommendation. No further comments are required from DFAS.

FMCOM and FMC Comments

The Commander, U.S. Army Financial Management Command, and the Director, Financial Management Center, did not comment on the recommendation.

Our Response

Although the Commander, U.S. Army Financial Management Command, and the Director, Financial Management Center, did not respond, they took action and developed SOPs, which DFAS reviewed, to guide Army CVS personnel in coding the contractor domain status. Therefore, their actions were responsive, meeting the intent of the recommendation. No further comments are required from U.S. Army Financial Management Command and Financial Management Center.

A.2. We recommend that the Commander, U.S. Army Financial Management Command and the Director, Financial Management Center:

- a. Incorporate procedures in the Computerized Accounts Payable System-Clipper training program for deploying Army Commercial Vendor Services personnel to correctly code the contractor domain status.**

Management Comments

The Deputy Assistant Secretary of the Army (Financial Operations) did not state agreement or disagreement. The Deputy Assistant Secretary stated that training has been modified to strengthen tax reporting procedures by correctly coding U.S. vendors.

Our Response

The Deputy Assistant Secretary of the Army (Financial Operations) comments were responsive, meeting the intent of the recommendation. No further comments are required from the Army.

- b. Establish a time-phased plan to review all payments to contractors in Iraq from January 1, 2006, forward to correctly code domestic contractors that are eligible for a Federal information return, and report the results of the review to the DoD Office of Inspector General.**

Management Comments

The Deputy Assistant Secretary of the Army (Financial Operations) did not state agreement or disagreement. The Deputy Assistant Secretary commented that work is in progress with FMC and DFAS to review CVS databases to identify U.S. vendors subject to tax reporting from 2006 through 2008. The Deputy Assistant Secretary also stated that work is ongoing with CAPS programmers to identify reportable payments in theater CAPS databases.

Our Response

The Deputy Assistant Secretary of the Army (Financial Operations) comments were responsive, and the stated actions meet the intent of the recommendation. In addition, we commend the Army for its work with CAPS-C support personnel to:

- identify reportable payments in-theater CAPS-C databases and
- produce accurate Forms 1099-MISC.

We do not require any further comments from the Army.

Finding B. Army CVS Offices Should Have Filed Federal Information Returns for Domestic Contractors

From January 1, 2006, through December 31, 2008, Army CVS offices in Iraq did not file or use the DFAS Tax Office to file Federal information returns for 363 potentially reportable payments from a total 394 payments made to system-identified domestic contractors. This occurred because the DoD FMR did not include all reporting requirements specified in Federal laws for Federal information returns. Further, FMCOM and FMC did not have processes for filing Federal information returns. Specifically, FMCOM and FMC did not:

- establish SOPs for Army CVS personnel to file Federal information returns, or
- adequately train deploying Army CVS personnel on their responsibilities to complete necessary data entry or to file Federal information returns.

As a result, Army CVS offices did not comply with Federal laws to file Federal information returns for payments made to domestic contractors. Therefore, Army CVS personnel did not take action to file Federal information returns with the IRS for up to \$37.54 million of contractor payments.

Completing and Filing Federal Information Returns is Necessary for Tax Reporting Compliance

Army CVS personnel in Iraq use CAPS-C to authorize vendor payments. CAPS-C can generate a tax file of contractors required to receive a Federal information return. Army CVS personnel can then either self-file the Federal information returns or send the CAPS-C tax file to the DFAS Tax Office, and the DFAS Tax Office will file the Federal information returns.

The DFAS Tax Office is responsible for coordinating the issuance of all DoD Federal information returns. Annually, the DFAS Tax Office develops a quality assurance plan for Federal information return processing. It also develops, maintains, and issues policies, procedures, guidelines, and manuals on the tax reporting process. Other functions include:

- advising DFAS executives on matters relating to Federal information return reporting to the IRS for DFAS contract and vendor pay systems;
- managing a centralized process for filing all Federal information returns for contract and vendor payments made by DFAS; and
- establishing and monitoring a system of internal controls to ensure Federal information return reporting is accurate, complete, and in compliance with laws and regulations.

Federal information return reporting involves providing one copy of the return to the IRS, as well as one copy to the contractor. Filing Federal information returns is important for

... tax reporting compliance is only about 50 percent overall when there is little to no information reporting.

tax reporting compliance. As the IRS National Taxpayer Advocate described in a statement before the U.S. Senate Subcommittee on Taxation and IRS Oversight in July 2006, tax reporting compliance is about 96 percent when payments are subject to

third-party information reporting. However, tax reporting compliance is only about 50 percent overall when there is little to no information reporting.

Army CVS Offices Should Have Filed Federal Information Returns for Contractors Coded as Domestic

From 2006 through 2008, Army CVS offices in Iraq processed 15,093 payments, totaling \$1.28 billion, potentially related to services through CAPS-C.⁵ Of the 15,093 payments, Army CVS personnel coded the contractors as domestic for 394 payments totaling \$42.82 million.⁶ Of the 394 payments to system-identified domestic contractors, 363 payments totaling \$37.54 million may have been eligible for Federal information return reporting because:

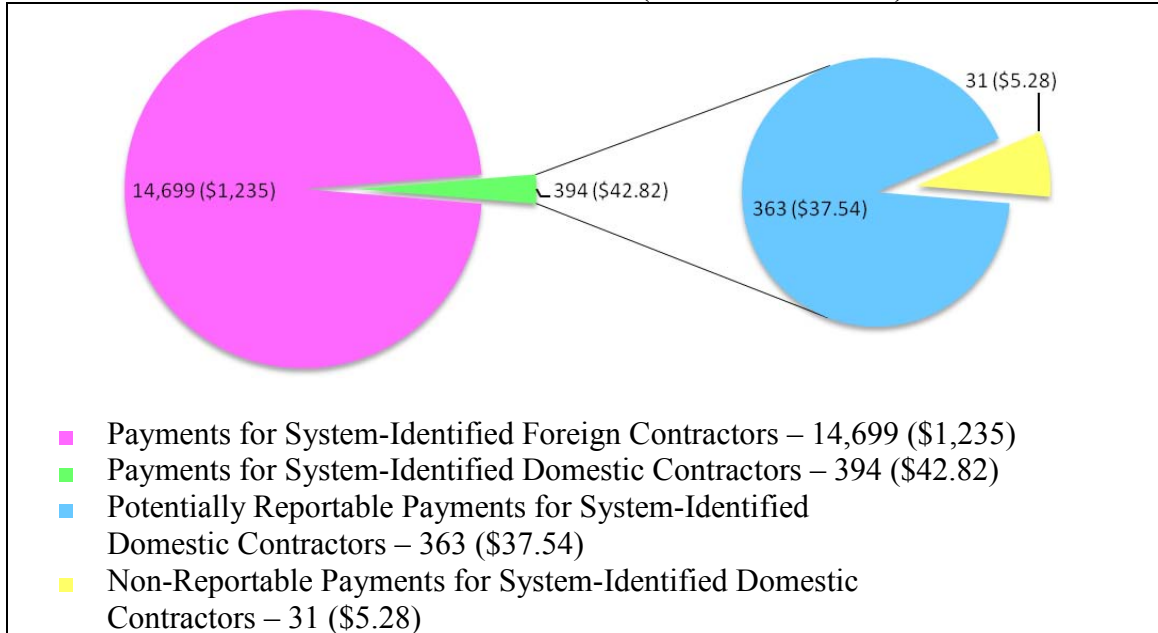
- the payments aggregated to at least \$600 in a calendar year for each of the system-identified domestic contractors, and
- the system-identified domestic contractors receiving the payments potentially provided reportable items.

See the Figure on page 12 for a breakdown of the payments processed by Army CVS offices in Iraq.

⁵ In the Figure, this amount is \$1,277.82 million (\$1,235 million + \$42.82 million).

⁶ The results of our sample for the remaining 14,699 payments (15,093 – 394) are discussed in Finding A.

Figure. Payments Processed by Army CVS Offices in Iraq, Calendar Years 2006-2008 (dollars in millions)



Army CVS offices in Iraq did not file Federal information returns for the 363 payments made to system-identified domestic contractors. They also did not send the CAPS-C tax file to the DFAS Tax Office for filing. The Table shows, by year, the total number and amount of payments potentially eligible for Federal information return reporting.

Table. Payments Potentially Eligible for Federal Information Return Reporting, 2006-2008

Year	Number of Payments	Total Amount of Payments (millions)
2006	75	\$4.67
2007	120	2.97
2008	168	29.90
Total	363	\$37.54

For example, 2 of the 363 payments were made to a Washington, D.C.-based corporation specializing in management consulting services. The contractor received the two payments totaling approximately \$1.28 million as payment for various polling services in Iraq, including surveys, public opinion polls, and focus groups. Army CVS offices did not report these payments, as well as other potentially eligible payments, because from 2006 through 2008, DoD regulations did not include all Federal information return reporting requirements specified in Federal laws. In addition, FMCOM and FMC had not established processes for filing Federal information returns. Specifically, they did not establish SOPs for or provide adequate training to Army CVS personnel on their responsibility for filing Federal information returns. As a result, Army CVS offices did not file required Federal information returns for up to \$37.54 million of payments.

DoD FMR Included Limited Federal Information Return Reporting Requirements

DoD regulations did not include all reporting requirements specified in 26 U.S.C. § 6041A (2008) for Federal information returns. Specifically, 26 U.S.C. § 6041A (2008) requires Federal executive agencies to prepare a Federal information return if they pay a corporation \$600 or more in a calendar year for services. DoD FMR, volume 10, chapter 6, required only reporting payments to corporate contractors if the payments applied to medical or health care services. Consequently, during calendar years 2006 through 2008, Army CVS personnel did not have adequate DoD guidance. However, DoD FMR, volume 10, chapter 6, was updated in September 2009 to include all Federal information return reporting requirements. Army CVS personnel did not comply with Federal laws because they did not take action to file Federal information returns totaling up to \$37.54 million.

Army CVS Offices Need Procedures to File Federal Information Returns

FMCOM provides oversight and policy for Army finance operations, including FMC. However, FMCOM did not establish and issue SOPs to FMC on Federal requirements for Army CVS offices to file Federal information returns. In addition, FMC personnel stated they were not aware of the Federal requirements to file Federal information returns. While FMC was responsible for establishing theater standards, including those for Army CVS offices, it did not establish procedures for Army CVS offices to file Federal information returns. As a result, Army CVS personnel in Iraq did not take action to file Federal information returns for 363 payments totaling \$37.54 million that may have required reporting.

Because the DFAS Tax Office cannot interface with the stand-alone CAPS-C entitlement systems, the DFAS Tax Office does not know which sites make contractor payments in theater.

To help system operators, such as CVS personnel, file Federal information returns, the DFAS Tax Office annually develops a quality assurance plan for Federal information return processing. The quality assurance plan details the processes required to complete a review of the CAPS-C tax file, correct errors and rejects, and complete final processing of the tax file. Because the DFAS Tax Office cannot interface with the stand-alone CAPS-C entitlement systems, the DFAS Tax Office

does not know which sites make contractor payments in theater. However, FMCOM is aware of functional Army CVS offices and could forward the annual quality assurance plan from the DFAS Tax Office to the appropriate sites.

Army CVS Personnel Need Adequate Training on Completing Data Entry and Filing Federal Information Returns

FMCOM and FMC did not ensure that Army CVS personnel in Iraq received adequate training on their responsibilities to complete necessary data entry or to file Federal information returns with the IRS. FMCOM trained deploying financial management

units on core competencies of the financial management mission. FMC coordinated pre-deployment training with FMCOM for financial management units and was responsible for ensuring that deploying financial management units received training on their mission and responsibilities. However, the training did not describe the processes to identify correct entries for data elements necessary for Federal information reporting, such as the “Amount Indicator” code and “Corporate Status.”

... training for deploying Army CVS personnel did not describe the processes or responsibilities to file Federal information returns.

CAPS-C requires certain entries in the “Amount Indicator” and “Corporate Status” fields for the system to include a payment in the CAPS-C tax file. Although FMCOM training instructed Army CVS personnel to complete these fields, it

did not explain how to identify the correct data to input into those fields. The training also did not explain the importance of completing the fields and their effect on Federal information return reporting. Further, training for deploying Army CVS personnel did not describe the processes or responsibilities to file Federal information returns. Army CVS personnel did not enter the correct data in the “Amount Indicator” and “Corporate Status” fields for 276 of 363 payments to system-identified domestic contractors. Therefore, these payments were not included in the CAPS-C tax file.

Conclusion

Army CVS offices did not file Federal information returns or send the CAPS-C tax file to the DFAS Tax Office for Federal information return filing for 363 potentially reportable payments made to system-identified domestic contractors. This occurred because DoD FMR did not include all Federal information return reporting requirements specified in 26 U.S.C. § 6041A (2008). However, DoD FMR, volume 10, chapter 6, was updated in September 2009 to include all Federal information return reporting requirements. In addition, FMCOM and FMC did not establish procedures for Army CVS offices to ensure that Army CVS personnel took action to file Federal information returns with the IRS. Further, FMCOM and FMC did not adequately train deploying Army CVS office personnel on their responsibilities to file Federal information returns. As a result, Army CVS offices in Iraq did not comply with Federal laws to file Federal information returns for contractor payments. Army CVS personnel did not take action to file Federal information returns with the IRS for up to \$37.54 million of payments to contractors.

FMCOM and FMC Management Actions

Because of the audit, FMC management became aware of the requirements for filing Federal information returns and began working with DFAS and financial management units in Iraq to meet Federal information return reporting requirements. FMCOM provided instructions to FMC for filing Federal information returns. In addition, FMCOM provided FMC the DFAS points of contact for additional assistance to file Federal information returns. Further, FMCOM conducted an initial review of training on procedures to file Federal information returns. FMCOM plans to perform additional analysis on including DFAS procedures in FMCOM training. FMC personnel

submitted payment records to the DFAS Tax Office for filing of Federal information returns for 2009. Finally, the DFAS Tax Office created a quality assurance plan for theater sites for the 2010 tax year.

Recommendations, Management Comments, and Our Response

B.1. We recommend the Director, Defense Finance and Accounting Service distribute the Defense Finance and Accounting Service Tax Office Quality Assurance Plan for Form 1099-MISC Printing and any other annual tax filing procedures or Defense Finance and Accounting Service Tax Office directives to U.S. Army Financial Management Command.

Management Comments

The Acting Director, Standards and Compliance, DFAS agreed. The Acting Director stated that FMCOM identified sites for DFAS, and DFAS then distributed a DFAS Tax Office quality assurance plan to those sites. The Acting Director indicated that this allowed DFAS to complete Form 1099-MISC files for 2010. The Acting Director stated the actions were completed December 15, 2010.

Our Response

The Acting Director, Standards and Compliance, DFAS, comments were responsive, and the actions meet the intent of the recommendation. No further comments are required.

B.2. We recommend the Commander, U.S. Army Financial Management Command:

a. Develop standard operating procedures requiring Army Commercial Vendor Services personnel to produce the Computerized Accounts Payable System-Clipper tax file annually and send the tax file to the Defense Finance and Accounting Service Tax Office for filing with the Internal Revenue Service.

Management Comments

The Deputy Assistant Secretary of the Army (Financial Operations) did not state agreement or disagreement. The Deputy Assistant Secretary stated that a revised SOP was published and distributed to Army financial management sites. The Deputy Assistant Secretary indicated that the SOP includes procedures on returning contracts to issuing contracting offices when the contracts do not include the necessary tax reporting information.

Our Response

The Deputy Assistant Secretary of the Army (Financial Operations) comments were responsive, and the actions meet the intent of the recommendation. In addition, we commend the Army for including procedures in the revised SOPs to address contracts that lack necessary tax reporting information. No further comments are required from the Army.

- b. Update training for deploying financial management units to include an explanation of the requirements for completing the “Amount Indicator” and “Corporate Status” data fields in the Computerized Accounts Payable System-Clipper.**
- c. Incorporate Computerized Accounts Payable System-Clipper tax file preparation into training for deploying financial management units and mission certification exercises for financial management units.**

Management Comments

The Deputy Assistant Secretary of the Army (Financial Operations) did not state agreement or disagreement. The Deputy Assistant Secretary stated that training has been modified to strengthen tax reporting procedures. The training establishes how to:

- correctly code U.S. vendors in CAPS-C and
- transmit tax files to DFAS.

Our Response

The Deputy Assistant Secretary of the Army (Financial Operations) comments were responsive, meeting the intent of the recommendations. We do not require any further comments from the Army.

B.3. We recommend the Director, Financial Management Center:

- a. Implement procedures that require Army Commercial Vendor Services personnel to produce the Computerized Accounts Payable System-Clipper tax file annually and send the tax file to the Defense Finance and Accounting Service Tax Office for filing with the Internal Revenue Service.**

Management Comments

The Deputy Assistant Secretary of the Army (Financial Operations) did not state agreement or disagreement. The Deputy Assistant Secretary stated that FMC:

- worked to make theater finance offices aware of tax filing requirements and
- established an SOP for theater vendor pay offices to retrieve tax identification numbers from CCR for U.S. vendors.

According to the Deputy Assistant Secretary, once obtained, the tax identification numbers will be coded in CAPS-C.

Our Response

The Deputy Assistant Secretary of the Army (Financial Operations) comments were responsive. The stated actions meet the intent of the recommendation, and we do not require any further comments from the Army.

b. Incorporate Computerized Accounts Payable System-Clipper tax file preparation into training and coordinate with U.S. Army Financial Management Command training for deploying financial management units.

Management Comments

The Deputy Assistant Secretary of the Army (Financial Operations) did not state agreement or disagreement. The Deputy Assistant Secretary commented that FMC's internal control staff is conducting training on new SOPs to ensure vendor pay offices are compliant.

Our Response

The Deputy Assistant Secretary of the Army (Financial Operations) comments were responsive, and the stated actions meet the intent of the recommendation. We commend the Army for its work to train theater personnel how to produce accurate Forms 1099-MISC. No further comments are required from the Army.

c. File Federal information returns for reportable payments made by Army Commercial Vendor Services offices in Iraq from January 1, 2006, forward, and report the filed payments to the DoD Office of Inspector General.

Management Comments

The Deputy Assistant Secretary of the Army (Financial Operations) did not state agreement or disagreement. The Deputy Assistant Secretary responded that there is continuing work to retrieve disbursement data for U.S. vendors from 2006 forward. The Deputy Assistant Secretary stated that once the data is available, applicable tax reporting will be completed.

Our Response

The Deputy Assistant Secretary of the Army (Financial Operations) comments were responsive, and the stated actions meet the intent of the recommendation. We do not require any further comments from the Army.

Appendix A. Scope and Methodology of Audit

We conducted this performance audit from November 2009 through December 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We determined whether Army CVS offices complied with regulations to file Federal information returns for payments to contractors. We reviewed relevant criteria to determine the requirements for filing Federal information returns. Specifically, we identified criteria from the United States Code, IRS instructions, and DoD FMR. In addition, we reviewed management policies and procedures regarding filing Federal information returns.

We visited FMCOM in Indianapolis, Indiana, and DFAS offices in Indianapolis, Indiana, and Rome, New York. We also contacted the DFAS Tax Office at DFAS Columbus. We conducted interviews with management personnel regarding:

- FMC and Army CVS office processes for filing Federal information returns,
- vendor pay personnel processes for determining a contractor's domain status, and
- DFAS Tax Office processes for filing Federal information returns.

We also communicated with FMC personnel in theater. We conducted meetings with management personnel regarding vendor pay personnel's processes for filing Federal information returns.

We obtained payment data from the CAPS-C Repository.* We filtered the data based on the audit scope and requirements for filing a Federal information return. We then selected a random sample of payments with a system-identified foreign contractor from the CAPS-C Repository. See Appendix C for more information on the statistical sample. We randomly selected 213 payments from the CAPS-C Repository. We obtained the voucher packages relating to the sampled payments from DFAS Rome. We also reviewed supporting contracts and contractor information. We obtained supporting contracts from the Electronic Document Access and Electronic Document Management systems and contractor information from the CCR database.

* The CAPS-C Repository consolidates multiple deployed CAPS-C databases into a single CONUS (continental United States) database.

We reviewed the voucher packages to determine whether the payments were reportable on Federal information returns. We identified reportable payments by reviewing the voucher packages for contracts with a preponderance of reportable items and contractors that:

- had a domestic domain status,
- were subject to Federal tax reporting, and
- received at least \$600 in a calendar year.

We also identified payments with a system-identified domestic contractor from the CAPS-C Repository. To determine whether the payments may have been reportable on a Federal information return, we obtained contractor information from the CCR database. Payments that may have been reportable included contractors that:

- received at least \$600 in a calendar year, and
- were specified in the CCR database as service providers or were assigned standard industry codes in the CCR database containing reportable items.

For all sampled items, we received a record of the Federal information returns filed by DFAS Tax Office for calendar years 2006 through 2008. We asked Army CVS offices to provide a record of the Federal information returns they filed for 2006 through 2008. We compared the payments we determined to be reportable to the Federal information returns filed by DFAS Tax Office and Army CVS offices.

Use of Computer-Processed Data

We used the CAPS-C Repository to select our sample of payments to contractors in Iraq. In addition, we used the CCR database to gather additional information about contractors. Further, we used the Electronic Document Access and Electronic Document Management systems to obtain contracts for the sampled payments. We tested the accuracy of the data during our sampling process by comparing the data from the CAPS-C Repository to the source vouchers. The data was sufficiently reliable for the purpose of our review.

Use of Technical Assistance

The DoD Office of Inspector General Quantitative Methods and Analysis Division assisted with the audit. See Appendix C for detailed information about the work performed by the Quantitative Methods and Analysis Division.

Prior Coverage of Federal Information Return Reporting and Army CVS Office Tax Reporting

During the last 5 years, the Government Accountability Office (GAO), the Department of Defense Inspector General (DoD IG), and the Army Audit Agency (AAA) have issued eight reports discussing Federal information return reporting and DoD payments to contractors by Army CVS offices in Southwest Asia. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted DoD IG reports can be

accessed over the Internet at <http://www.dodig.mil/audit/reports>. Unrestricted Army reports can be accessed from .mil and gao.gov domains over the Internet at <https://www.aaa.army.mil/>.

GAO

GAO Report No. GAO-09-238, “Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements,” January 2009

GAO Report No. GAO-08-266, “Tax Administration: Costs and Uses of Third-Party Information Returns,” November 2007

GAO Report No. GAO-07-742T, “Tax Compliance: Thousands of Federal Contractors Abuse the Federal Tax System,” April 19, 2007

DoD IG

DoD IG Report No. D-2008-098, “Internal Controls Over Payments Made in Iraq, Kuwait, and Egypt,” May 22, 2008

AAA

AAA Report No. A-2010-0062-ALL, “Controls Over Vendor Payments – Southwest Asia (Phase II),” March 16, 2010

AAA Report No. A-2010-0057-ALL, “Controls Over Vendor Payments – Southwest Asia (Phase II),” February 24, 2010

AAA Report No. A-2010-0012-ALL, “Controls Over Vendor Payments – Southwest Asia (Phase II),” January 5, 2010

AAA Report No. A-2009-0173-ALL, “Controls Over Vendor Payments – Kuwait (Phase I – U.S. Army Contracting Command, Southwest Asia, Camp Arifjan, Kuwait),” July 29, 2009

Appendix B. 2008 Form 1099-MISC, “Miscellaneous Income”

9595		<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0115		Miscellaneous Income
PAYER'S name, street address, city, state, ZIP code, and telephone no.		1 Rents	2008		Form 1099-MISC	
		2 Royalties				
		\$			3 Other income	4 Federal income tax withheld
		\$			\$	\$
PAYER'S federal identification number	RECIPIENT'S identification number	5 Fishing boat proceeds	6 Medical and health care payments		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2008 General Instructions for Forms 1099, 1098, 5498, and W-2G.	
		\$	\$			
RECIPIENT'S name		7 Nonemployee compensation	8 Substitute payments in lieu of dividends or interest			
		\$	\$			
Street address (including apt. no.)		9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>	10 Crop insurance proceeds			
City, state, and ZIP code		11	12			
Account number (see instructions)	2nd TIN not <input type="checkbox"/>	13 Excess golden parachute payments	14 Gross proceeds paid to an attorney			
		\$	\$			
15a Section 409A deferrals	15b Section 409A income	16 State tax withheld	17 State/Payer's state no.		18 State income	
\$	\$	\$			\$	

Form 1099-MISC Cat. No. 14425J Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

Source: Internal Revenue Service

Appendix C. Statistical Sampling Methodology

Sampling Purpose

We used statistical sampling to estimate the number of errors and associated dollar error of payments in the CAPS-C Repository. A statistical sample allows the sample results to be projected to the population.

Population

DFAS personnel provided the audit team data from 14 locations in Iraq extracted from the CAPS-C Repository. The population included 24,252 records in the CAPS-C Repository, totaling \$1,846,415,814. These records represent payments in Iraq to commercial vendors. Of the 24,252 records, auditors determined 15,093 records, totaling \$1,277,874,038, represented entitlements that could be reportable on a Federal information return.

Sampling Design

A stratified sample by payment dollars was used. See Table C-1 for the strata breakdown and number of sample items by stratum.

Table C-1. Population Breakdown by Value of Payments

Value of Payment	Total Value	Stratum Size	Sample Size
Value < \$10,000	\$27,140,591	7,704	20
\$10,000 ≤ Value < \$100,000	192,004,032	5,495	30
\$100,000 ≤ Value < \$1,000,000	478,293,748	1,701	80
\$1,000,000 ≤ Value < \$5,000,000	316,674,520	160	50
Value ≥ \$5,000,000	263,761,147	33	33
Total	\$1,277,874,038	15,093	213

After the original sample was selected, we identified 394 records in the population that would be addressed separately. The 394 records related to contractors that were coded in the CAPS-C Repository as domestic contractors. These records were removed from the population and seven sample items belonging to the 394 records were removed from the sample. See Table C-2 for the strata breakdown and number of sample items by stratum in the revised population.

Table C-2. Revised Population Breakdown by Value of Payments

Value of Payment	Total Value	Stratum Size	Sample Size
Value < \$10,000	\$26,698,694	7,499	20
\$10,000 ≤ Value < \$100,000	188,923,333	5,389	30
\$100,000 ≤ Value < \$1,000,000	455,177,572	1,625	76
\$1,000,000 ≤ Value < \$5,000,000	306,918,316	154	48
Value ≥ \$5,000,000	257,334,968	32	32
Total	\$1,235,052,883	14,699	206

Analysis and Interpretation

We project with 90-percent confidence¹ that between 0.3% and 4.6%, with a point estimate of 2.1%, of the payments in the CAPS-C Repository will have a contractor that should have been issued a Federal information return but was not. The corresponding number of payments ranges from 45 through 680, with a point estimate of 316. See Table C-3 for a summary of this statistical projection.

Table C-3. Errors, Rate Projection

	Lower Bound²	Point Estimate³	Upper Bound²
Rate	0.3%*	2.1%	4.6%
Number	45*	316	680

* Because the statistically calculated lower bound is negative, the sample result is the lower bound. This produces an asymmetric interval and the point estimate is not the midpoint of the lower and upper bounds.

¹ The confidence level is a number, stated as a percentage, that expresses the degree of certainty associated with an interval estimate of a population parameter.

² Confidence intervals are an estimate of a population parameter that consists of a range of values bounded by what are known as the upper and lower bounds.

³ A point estimate is a statistically based estimate that is a single numerical value.

We project with 90-percent confidence that the dollar value of payments in the CAPS-C Repository that have a contractor that should have been issued a Federal information return but was not, is from \$282,840,915 through \$421,006,585, with a point estimate of \$351,923,750. See Table C-4 for a summary of this statistical projection.

Table C-4. Errors, Dollar Value Projection

	Lower Bound	Point Estimate	Upper Bound
Errors	\$282,840,915	\$351,923,750	\$421,006,585

We project with 90-percent confidence that between 21.4% and 47.4%, with a point estimate of 34.4%, of the payments in the CAPS-C Repository will have a contractor that potentially should have been issued a Federal information return but was not. The corresponding number of payments ranges from 3,144 through 6,964, with a point estimate of 5,054. See Table C-5 for a summary of this statistical projection.

Table C-5. Potential Errors, Rate Projection

	Lower Bound	Point Estimate	Upper Bound
Rate	21.4%	34.4%	47.4%
Number	3,144	5,054	6,964

We project with 90-percent confidence that the dollar value of payments in the CAPS-C Repository that have a contractor that potentially should have been issued a Federal information return but was not, is from \$185,805,525 through \$311,520,193, with a point estimate of \$248,662,859. See Table C-6 for a summary of this statistical projection.

Table C-6. Potential Errors, Dollar Value Projection

	Lower Bound	Point Estimate	Upper Bound
Potential Errors	\$185,805,525	\$248,662,859	\$311,520,193

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE
ARLINGTON
1851 SOUTH BELL STREET
ARLINGTON, VA 22240-5291

DFAS-JJ

JAN 24 2011

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE DoD

SUBJECT: Management Comments to DoDIG Draft Report, "Army Commercial Vendor
Services Offices in Iraq Noncompliant with Internal Revenue Service Reporting
Requirement," Dated December 21, 2010, Project D2009-D000FH-0292.000

Attached are management comments to recommendations A.1 and B.1 for subject report.

If you have questions or concerns regarding these comments your staff may contact

[REDACTED]

A handwritten signature in black ink, appearing to read "RD Davis", is positioned above the printed name.

Richard D. Davis
Acting Director, Standards & Compliance

Attachment:
As stated

**Management Comments to DoDIG Draft Report, "Army Commercial Vendor Services
Offices in Iraq Noncompliant with Internal Revenue Service Reporting
Requirement," Dated December 21, 2010, Project D2009-D000FH-0292.000**

Recommendation A.1: We recommend the Director, Defense Finance and Accounting Service, in conjunction with the Commander, U.S. Army Financial Management Command, and the Commander, Financial Management Center, establish formal standard operating procedures to guide Army Commercial Vendor Services personnel in correctly coding the contractor domain status as either domestic or foreign in the Computerized Accounts Payable System-Clipper.

Management Comments: Concur. DFAS has completed a Quality Assurance Plan to advise the Army Commercial Vendor Services personnel which payments are reportable on tax documents, how to code payments, work the yearly 1099 report, and generate the final yearly file. FINCOM has completed a draft SOP that will be reviewed by the DFAS.

Estimated Completion Date: March 1, 2011

Recommendation B.1: We recommend the Director, Defense Finance and Accounting Service distribute the Defense Finance and Accounting Service Tax Office Quality Assurance Plan for Form 1099-MISC Printing and any other annual tax filing procedures or Defense Finance and Accounting Service Tax Office directives to U.S. Army Financial Management Command.

Management Comments: Concur. DFAS distributed the Tax Office Quality Assurance Plan to all sites identified by the U.S. Army Financial Management Command December 15, 2010. This enabled us to complete the 1099-Misc files for 2010.

Completion Date: December 15, 2010



**DEFENSE FINANCE AND ACCOUNTING SERVICE
ARLINGTON
1851 SOUTH BELL STREET
ARLINGTON, VA 22240-5291**



DFAS-JJ

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCIAL AUDITING SERVICE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF
DEFENSE (DoD)

SUBJECT: Management Comments to DoDIG Draft Report, "Army Commercial Vendor
Services Offices in Iraq Noncompliant with Internal Revenue Service Reporting
Requirement," Dated December 21, 2010, Project D2009-D000FH-0292.000

Attached are management comments to recommendations A.1.

If you have questions or concerns regarding these comments your staff may contact
[REDACTED]

Richard D. Davis
Acting Director, Standards & Compliance

Attachment:
As stated

**Management Comments to DoDIG Draft Report, "Army Commercial Vendor Services
Offices in Iraq Noncompliant with Internal Revenue Service Reporting
Requirement," Dated December 21, 2010, Project D2009-D000FH-0292.000**

Recommendation A.1: We recommend the Director, Defense Finance and Accounting Service, in conjunction with the Commander, U.S. Army Financial Management Command (FINCOM), and the Commander, Financial Management Center; establish formal standard operating procedures to guide Army Commercial Vendor Services personnel in correctly coding the contractor domain status as either domestic or foreign in the Computerized Accounts Payable System-Clipper.

Prior Management Comments: Concur. DFAS has completed a Quality Assurance Plan to advise the Army Commercial Vendor Services personnel which payments are reportable on tax documents, how to code payments, work the yearly 1099 report, and generate the final yearly file. FINCOM has completed a draft SOP that will be reviewed by the DFAS.

Prior Estimated Completion Date: March 1, 2011

Current Management Comments: DFAS completed the review of FINCOM's SOP. DFAS recommended that FINCOM issue the SOP to all applicable sites with the following supplemental material: all modules from the Computerized Accounts Payable (CAPS) Clipper training including the Tax Table Maintenance Procedures, the DFAS Tax Office Quality Assurance Plan and criteria for what is/is not reportable, DFAS procedures for registering a Vendor in the Centralized Electronic Funds Transfer (CEFT) System and instructions on analyzing data from the Central Contractor Registry (CCR).

Completion Date: March 1, 2011

Department of the Army Comments



REPLY TO
ATTENTION OF

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
FINANCIAL MANAGEMENT AND COMPTROLLER
109 ARMY PENTAGON
WASHINGTON DC 20310-0109


FEB 09 2011

MEMORANDUM FOR Inspector General, Department of Defense, 400 Army Navy Drive, Arlington, Virginia 22202-4704

SUBJECT: Army Commercial Vendor Services (CVS) Offices in Iraq Noncompliant with Internal Revenue Service Reporting Requirements (Project No. D2009-D000FH-0292.000)

1. Reference subject draft audit report, dated December 21, 2010.
2. We have reviewed subject report and agree that prior to tax year 2009 the Army CVS offices in the contingency theater of operations were not performing informational tax reporting for those U.S. non-corporate vendors being paid locally for services provided in support of military forces. We are awaiting details from the auditors on the 363 payments identified in the report. It is our understanding from the audit team that the larger projection of 5,054 potential errors was based on criteria which included all payments made in US Dollars regardless of vendor name or address. Although the scope of the audit did not incorporate the end-to-end process, we believe the root cause of errors in capturing and reporting this data starts with initial creation of a contract with the vendor. Specific responses by recommendation are attached.
3. My point of contact for this matter is [REDACTED].

Encl


John J. Argodale
Deputy Assistant Secretary of the Army
(Financial Operations)

**Department of Defense Inspector General Draft Report for
The Audit of Army Commercial Vendor Services Offices
In Iraq Noncompliant with Internal Revenue Service
Reporting Requirements
(Project D2009-D000FH-0292.000)**

**Deputy Assistant Secretary of the Army (Financial Operations)
Response to the Draft Audit Recommendations**

DoDIG Recommendation A.2: We recommend that the Commander, U.S. Army Financial Management Command and the Commander, Financial Management Center:

- a. Incorporate procedures in the Computerized Accounts Payable System-Clipper training program for deploying Army Commercial Vendor Services personnel to correctly code the contractor domain status.
- b. Establish a time-phased plan to review all payments to contractors in Iraq from January 1, 2006, forward to correctly code domestic contractors that are eligible for a Federal information return, and report the results of the review to the DoD Office of Inspector General.

Management Response: Pre-deployment training has been modified to strengthen informational tax reporting procedures and establishing the correct code to identify US vendors when applicable. In conjunction with the Financial Management Center in Kuwait and the Defense Finance and Accounting Service, individual commercial vendor services' databases are being centrally reviewed and manipulated to isolate potential U.S. vendors subject to informational tax reporting beyond those already reported to the Internal Revenue Service for 2009 forward. We are working with the CAPS programming staff to identify reportable payments in the CAPS databases from theater in order to report them when tax identification can be obtained.

DoDIG Recommendation B.2: We recommend that the Commander, U.S. Army Financial Management Command:

- a. Develop standard operating procedures requiring Army Commercial Vendor Services personnel to produce the Computerized Accounts Payable System (CAPS)-Clipper tax file annually and send the tax file to the Defense Finance and Accounting Service Tax Office for filing with the Internal Revenue Service.
- b. Update training for deploying financial management units to include an explanation of the requirements for completing the "Amount Indicator" and "Corporate Status" data fields in the Computerized Accounts Payable System-Clipper.

c. Incorporate Computerized Accounts Payable System-Clipper tax file preparation into training for deploying financial management units and mission certification exercises for financial management units.

Management Response: A revised Standing operating procedure (SOP) has been published and furnished to the Army financial management network. As recommended by the auditors, the SOP incorporates returning contracts to the issuing contracting office when the vendor has a U.S. address but the requisite tax reporting information is not included. We modified pre-deployment training to strengthen informational tax reporting procedures through establishing the correct code to identify US vendors in the Computerized Accounts Payable System-Clipper when applicable, and transmission of files to the Defense Finance and Accounting Service.

DoDIG Recommendation B.3: We recommend that the Commander, Financial Management Center:

a. Implement procedures that require Army Commercial Vendor Services personnel to produce the Computerized Accounts Payable System-Clipper tax file annually and send the file to the Defense Finance and Accounting Service Tax Office for filing with the Internal Revenue Service.

b. Incorporate Computerized Accounts Payable System- Clipper tax file preparation into training and coordinate with U.S. Army Financial Management Command training for deploying financial management units.

c. File Federal information returns for reportable payments made by Army Commercial Vendor Services Offices from January 1, 2006, forward, and report the filed payments to the DoD Office of Inspector General.

Management Response: The 266th Financial Management Center (Theater) made theater finance offices aware of the tax filing requirements in November 2010, when they assumed responsibility from the 326th FMC. Since then, the 266th FMC has directed a standard operating procedure for all vendor pay offices in the OND/OEF theaters requiring finance units to retrieve US vendor tax identification numbers (TIN) from the Central Contractor Registry (CCR). Once obtained, the TINs will be coded into CAPS-C. Internal Control teams of the 266th FMC are conducting training on the new SOP and will ensure its compliance as they make routine technical reviews of vendor pay offices. Efforts to retrieve US vendor disbursement data from 2006 forward are ongoing; applicable tax reporting will be done as that data becomes available.



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